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NO. 751

In the Supreme Court of the United States

OCTOBER TERM, 1967

OSCAR E. BAAN AND EVELYN K. BAAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

ERWIN N. GARNWOLD,

Solicitor General,

Department of Justice,

Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 781

OSCAR E. BAAN AND EVELYN K. BAAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

MEMORANDUM FOR THE RESPONDENT

In 1961, Pacific Telephone and Telegraph Company (Pacific) transferred part of its operating assets and cash to Pacific Northwest Bell Telephone Company (Northwest), a newly-formed corporation, in exchange for all of the stock and a \$200,000,000 demand note of Northwest. Pacific announced that it would ultimately sell to its own stockholders all the Northwest stock. The number and timing of offerings, and the price to be paid for the Northwest stock, were left to the future decisions of Pacific's management.

The first offering was in 1961, when Pacific issued to its stockholders transferable rights to purchase at \$16 per share 57 percent of the Northwest stock, the market value of which was then over \$26 per share.

(1)

Pacific disposed of the remaining 43 percent in 1963 through a similar offering.

Petitioners are stockholders of Pacific who received and exercised stock rights in 1961. The issue here is the tax consequences of that transaction.

The Tax Court held that petitioners need not recognize gain on the receipt or exercise of the stock rights because the overall transaction qualified as a tax free spin-off under Section 355 of the Internal Revenue Code of 1954. On the Commissioner's appeal, the Ninth Circuit reversed the decision of the Tax Court. (Pet. App. C 52-55, 75.)

The Second Circuit considered the identical question in *Commissioner v. Gordon* (decided July 26, 1967, 67-2 U.S.T.C., par. 9592), pending on the Commissioner's petition for a writ of certiorari, No. 760, this Term. *Gordon* arises from the same transaction, and was tried and decided together with this case in the Tax Court. The Second Circuit, Judge Friendly dissenting, disagreed with the Ninth Circuit, and held that the transaction met the requirements of Section 355. The decision here is therefore in direct conflict with that of the Second Circuit.

In view of the conflict between the courts of appeals and its impact on the tax liability of some 2,000 Pacific shareholders (see petition for writ of certiorari in No. 760, pp. 6-7), respondent does not object to the granting of this petition.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

NOVEMBER 1967.